The University of Chicago

THE CREDIT-UNION LEGAL FRAMEWORK

A PART OF A DISSERTATION SUBMITTED TO THE FACULTY OF THE SCHOOL OF BUSINESS IN CANDIDACY FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

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LINCOLN H. CLARK

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CREDIT UNIONS IN THE UNITED STATES

LINCOLN CLARK[1]

INTRODUCTION

CREDIT unions may be viewed as a type both of co-operative and of small-loan institution. Up to the outbreak of war, credit unions were the most rapidly developing form of co-operative enterprise. In the small-loan field, credit unions have surpassed pawnbrokers in the volume of business. Their rapid growth has given rise to grandiose claims and disparaging countercharges, making credit unions a lively topic of discussion in regard to both their co-operative nature and their small-loan operations. The primary purpose of this study is to evaluate credit unions as a co-operative effort on the part of persons of small means to provide themselves with credit opportunities at low rates of interest and to suggest possible legislative and administrative improvements in their operations.

A union of persons to supply a source of credit to its members results in a credit union. Credit unions must receive legal authorization to operate from either the federal government, the District of Columbia, or one of the forty-three states which have enacted enabling legislation. Credit unions are commonly termed co-operative associations for "savings and loans," but their true function is more accurately described if the order of purposes is reversed to "loans and savings."

Credit unions are formed by groups each of the members of which pays a nominal entrance fee and purchases or makes a down payment on at least one share of fixed par-value stock. Persons join credit unions to secure loans at low rates of interest and to have a safe repository for their savings, which are entitled to the profit earned by the credit union on its loan operations.

THE DEVELOPMENT OF CO-OPERATIVE CREDIT

The development of co-operative credit during the past century has been an organized movement to help the small man meet his credit needs. In some cases this has meant provision of a source of credit where none existed before and in others availability of capital at rates of interest lower than those charged by private lenders. Co-operative credit has been designed to render service to an individual in any one of his three economic capacities: as a producer, as a financier, and as a consumer. For example, a farmer, as a producer, may borrow to purchase seed and equipment; as a financier, he may refinance various forms of indebtedness; and as a consumer, he may seek to defer payment of goods wanted for immediate use. Since all these services may be provided by the same credit association, there is no functional justification for classifying credit unions according to the end-use of the credit, i.e., productive or consumptive, as is the common practice in the credit field.

European antecedents.—Although the credit union in the United States today is unique in the world, its form, like that of most of our economic institutions, has European roots. Rather than relate the history of credit co-operation, this study

[1] The author is at present in the employ of the War Production Board. This is the first of two articles; the second will appear in the January, 1944, issue.

will discuss the philosophical precursors and organizational adaptations to the changing needs of borrowers in different nations and generations, with special attention to those developments leading to the American credit union of today.[2]

Credit co-operatives are but one part of the multi-sided co-operative movement, whose schema was laid down by Owen in England and Fourier in France. The co-operative utopias they founded were less successful, however, than the ideas they promulgated. Their principal contributions to co-operative thought were, first, the concept that by voluntary collective action persons can satisfy their needs more economically and equitably than by individual action or through state control and, second, the anarchistic view that disregards and even renounces the state as an instrument for economic betterment. More in keeping with the economic conditions of their time, as well as with present-day co-operative thought, were the views of the Germans —Huber, Pfeffer, Schulze-Delitzsch, and Raiffeisen—who considered co-operatives a self-help means of protection against exploitation and for economic betterment for the lower-middle and working classes. Their plans were to be worked out in and as part of the prevailing economic system, without consideration for "the ultimate co-operative commonwealth."

The Schulze-Delitzsch credit system.—The program for economic co-operation developed concurrently in England, France, and Germany in the 1840's—a decade of general economic disturbances and social unrest. Following the conception of the co-operative method as a universal panacea, specialized forms of co-operative enterprise emerged to attain specific ends. The procedures of the American credit union have been adapted largely from those of the Schulze-Delitzsch and Raiffeisen credit systems.

It is interesting to note that the credit movement was started in Germany by wealthy bourgeoisie with the consequent opposition of the Socialists. In 1850, Hermann Schulze, then mayor of Delitzsch, persuaded a few men of parts to place a sum of money at the disposal of a society of needy artisans. The money was then loaned for purchases of tools and materials as a remedial effort to alleviate unemployment. The sponsors were to be rewarded with interest if the loans were repaid or with the satisfaction of their own philanthropy if not. The loans *were* repaid, with interest, in small monthly instalments, and the profits were held as a fund for further loans. Schulze-Delitzsch completed the transition from philanthropic financing to the self-supporting and self-governing credit co-operative two years later when he organized a society with a loan fund furnished entirely by the members. After an intensive organizational campaign he fostered the formation of a central bureau to promote co-operation further. Schulze-Delitzsch and his followers strongly opposed state aid of all sorts, which soon aroused the enmity of the government bureaucracy. Largely through their efforts, however, the first enabling act for co-operatives was passed in Prussia in 1867 and was followed by a co-operative law for the German Empire in 1869.

A Schulze-Delitzsch bank typically is managed by three full-time employees responsible to a supervisory committee elected by the members. Loans are granted exclusively to members, who are primarily small industrialists and trades-

[2] Cf. Elsie Gluck, "Cooperation—General Survey," *Encyclopaedia of the Social Sciences* (1931), ed. E. R. A. Seligman, IV, 359; and National Education Association of the United States, *Consumer Cooperatives: Report of the Committee on Cooperatives* (Washington: National Education Association, 1940).

men desirous of capital for commercial purposes rather than workers in need of personal loans. Each member subscribes for a share on which dividends are paid. The price of the shares is usually high (between $75 and $250), to provide the bank with working capital and to encourage thrift. Customarily, unlimited liability is specified in the by-laws in order to enable the bank to offer greater security for loans sought from other financial institutions. The effect of the provision for unlimited liability and the high price of shares is to limit the potential membership to the wealthier members of the community.

The three main resources of Schulze-Delitzsch banks—shares, unlimited liability, and reserve funds accumulated by allocations from earnings—serve as the principal basis of credit for loans. Other devices include short-term and long-term interest-bearing deposit accounts, non-interest-bearing drawing accounts, rediscount of outstanding loans, and trade bills of exchange. Probably the principal innovation of the Schulze-Delitzsch banks has been the popularization of co-signer loans.

The Raiffeisen model.—F. W. Raiffeisen, burgomaster of a group of small villages around Neuwied, Germany, evolved a plan to serve farmers' credit needs, based in part on the Schulze-Delitzsch system. Raiffeisen observed that, while farmers customarily have little cash, they do have other forms of assets which could serve as a basis for credit. This led to the basic principle of the Raiffeisen society of unlimited liability and nominal value of shares (usually about $2.50). To minimize risks, selection of members is made on the basis of character, sobriety, religious fervor, and general reputation in the village. To reduce credit investigation and collection costs, membership is confined to a single parish. To guard against faulty direction, the most educated person in the parish, usually the pastor or priest, acts as overseer. To maintain continuity of operation a cashier is employed, usually at a nominal salary.

The profit earned by the Raiffeisen society is not distributed to the members as individuals, but, after allocation to a reserve fund for bad debts, the balance is expended for the collective benefit of the members and the community. To maintain and control the flow of additional cash, however, interest is paid on deposit accounts. Both members and nonmembers may have deposit accounts, but purchase of a share is prerequisite to membership and loan privileges.

The loan applicant secures two indorsers of his note. (Unsecured and collateral loans are rarely issued.) The borrower, in addition to satisfying the society as to his character, must specify the purpose of the loan, which must be for a business purpose with convincing promise of successful outcome. Since most loans are for productive farm purposes, they may run from five to ten years, with interest of 4–5 per cent.

In addition to being associations for credit, Raiffeisen groups have sought to aid one another spiritually and socially. They have also engaged in co-operative buying and selling of farm necessities and products.

Before his death in 1888, Raiffeisen was able to count, in Germany alone, 425 societies of the type that bore his name. Since then, tens of thousands of them have been set up in agricultural countries in Europe and Asia. The Nazis have in recent years taken over and exploited those in localities under their domination, depriving them of all democratic control.

Comparison of Schulze-Delitzsch and Raiffeisen associations.—Although both

Schulze-Delitzsch and Raiffeisen societies have the same fundamental objective—to provide low-priced credit for members—their differing policies and procedures may explain the feeling of enmity between the supporters of the two sides. Some of the differences spring from the philosophies of the two founders, but in the main they can be attributed to the differing needs of the types of groups served.

Philosophically in keeping with the ideas of their founder, the rural Raiffeisen societies have retained their religious and moral character motivated by a spirit of mutual help. The larger urban Schulze-Delitzsch associations have confined their activities, for the most part, to the single purpose of granting loans for their members' commercial use.

The Schulze-Delitzsch associations, begun with few membership restrictions, have grown into an integrated banking system with thousands of full-time employees, imposing edifices, and all the outward signs of modern private banks. The Raiffeisen societies, on the other hand, with their limited parish memberships and simple type of transactions, have acquired no such appurtenances. Their physical requirements are fulfilled by a desk in the back of the local store where elected volunteer officials of the society have "office hours" two or three times a week. Such differences in method of operation may partly explain the lower rates charged by Raiffeisen societies. Other differences arise even more directly from the needs of the urban, as against the rural, community. The Schulze-Delitzsch associations do a general banking business customarily on three months' paper without detailed inquiry into the projected use of the loan. The Raiffeisen loans, however, are the simplest type of long-term credits, repayable in installments, and granted only for specific productive purposes.

Credit-union adaptations from German antecedents.—Since American credit unions are concentrated more in urban than in rural areas, one would expect to find American urban credit unions patterned more after the Schulze-Delitzsch than after the Raiffeisen model; but this is not the case. The Schulze-Delitzsch credit association is properly considered antecedent to modern commercial banks, except that it is a co-operative type of enterprise. The Raiffeisen society, on the other hand, sets the simpler pattern for credit unions.

Whereas the Schulze-Delitzsch and Raiffeisen associations developed because of unavailability of adequate private commercial banking facilities, the growth of credit unions in this country has been largely a response to dissatisfaction with only one part of the financial system—the small-loan field. Credit unions have followed the Raiffeisen policy of limiting membership to homogeneous groups, controlling by the rule of "one member—one vote," maintaining low operating costs, making cosigner loans and low-par-value shares ($5.00–$10.00) in order to avoid membership discrimination on the basis of wealth. A notable variation, however, is the generally accepted credit-union provision of limited liability of shareholders, so that members will not be subject to financial hazards in excess of their invested capital.

Italian adaptations of the German co-operative credit systems.—As the co-operative credit movement spread throughout Europe, changes were made in the Schulze-Delitzsch and Raiffeisen models to fit particular needs. Luigi Luzzatti, who became Italian minister of finance and prime minister, organized credit societies in Italian cities in the 1860's, based on the experience of Schulze-De-

litzsch, whom he had known in earlier years. Many of the Italian adaptations have been carried over to this continent. Shares were made smaller, liability was limited, small loans were encouraged, and representative managing boards of unpaid officials were elected. Careful attention was given to the selection of members, which made it possible to extend unsecured loans. Emphasis was placed on helping the man of small means. In addition to the Luzzatti-fostered urban co-operative credit movement, a rural Raiffeisen-model movement was led by Leone Wollemberg. In contrast to Raiffeisen, Wollemberg minimized the religious motivation and character of rural credit societies. The third adapter, Luigi Cerutti, introduced Wollemberg's program to Catholic groups in Venice. Thus, through convenience rather than through intent, Wollemberg gained homogeneity of membership on the basis of common occupation—farming—and Cerutti on the basis of common religion. These examples of membership classification influenced the establishment of the clear-cut delimitations of membership in American credit unions.

Other co-operative credit developments.—Although co-operative credit has spread from Germany and Italy to other countries, the adaptations made by the latter to suit particular needs have been further from, rather than nearer to, the American principles of credit-union operation. Since it is the aim of this section to trace the development of the movement to our own shores, the people's banks of Belgium, France, Switzerland, and Russia are not included.

It may be noted in passing that India leads the world with over 4,000,000 members belonging to over 100,000 Raiffeisen-model co-operative credit societies in both rural and urban areas. Japan has also had a large development of rural co-operative credit societies.

La Caisse populaire.—Although the history of co-operative credit dates back almost a century, modern credit-union history began in 1900 with the organization of La Caisse populaire in Levis, Quebec, by Alphonse Desjardins. In the course of his journalistic career, Desjardins became aroused by the effects on the poor people in Montreal of the activities of unscrupulous and usurious moneylenders. He organized credit societies among rural parish groups with adaptations from Schulze-Delitzsch, Raiffeisen, Luzzatti, Wollemberg, and Cerutti societies, whose operations he had studied in Europe. Shares were of small denominations; liability was limited; dividends were paid to shareholders; deposits were accepted, but only from members; and "redemptive" as well as "productive" loans were granted. The latter innovation characterizes the "consumer" nature of the greater part of the loans made by credit unions in this country.

Because individual promoters always stand out, there has been a tendency on the part of observers to overestimate their importance in the development of credit unions. For example, according to Bergengren, the credit unions organized by Desjardins in the Province of Quebec were carried on in cooperation with the local parish priests. Incidentally, the credit union movement in Quebec was the work of this one man. No other outstanding leaders came out of the credit unions he produced, and with his death the progress in credit union organization in Quebec came practically to an end.[3]

Developing this theme, Father Edward Dowling, of St. Louis, quoted this passage in an address on "Parish Credit Unions" at the 1940 Congress of the Co-operative League of the U.S.A. He im-

[3] Roy F. Bergengren, *CUNA Emerges* (Madison, Wis.: Credit Union National Association, 1936), pp. 16.

plied that the weakness of these credit unions lies in the insignificant role taken by the members. He expressed the view that the last thing the average priest wants is co-operation with the members and that priests usually dominate and run parish credit unions. He went on to say that it is a sad commentary on the Quebec credit-union movement that its development stopped with Desjardins's death.

Father Dowling's criticisms, which represent an often heard point of view, are founded on an inaccurate interpretation of credit-union development. Philosophers can conceive plans and credit-union promoters can organize credit unions, but they cannot make them grow. Desjardins was responsible for the organization of one hundred and fifty parish credit unions in fifteen years but not for their subsequent growth. Credit-union promoters may be considered catalytic agents in the social process of bringing borrowers and lenders together. With respect to the implications of Desjardins's work, the facts are that there are now more parish credit unions in Quebec than in the whole of the United States. It seems probable that before Desjardins died he approached the organizational saturation point of parish credit unions. Recently there has been a spurt in the number of credit unions in Quebec, which is to be attributed less to priests or lay promoters than to the needs of groups of industrial workers now organizing on the basis of common employment rather than common religion. Thus, of the several possible bases for social grouping, Desjardins used only one —the parish—but used it to the utmost.

CREDIT UNIONS IN THE UNITED STATES

In turning to the development of the credit-union movement in the United States, it is necessary to remember that the increase in the demand for consumer credit is a more important factor in the growth of credit unions than the education by which one individual shows groups how to help themselves.

Each noted leader in the credit-union movement has been aided as well as inspired by the work of predecessors. Soon after Desjardins came to the United States, he met Edward A. Filene, the Boston merchant and philanthropist. Mr. Filene had studied the co-operative credit movement in his travels in Europe, India, and Japan. He had become convinced that the movement offered a way for social betterment through the democratization of credit and the education of the rank and file of the people in the management and control of money. Filene supplied funds and respectability, Desjardins experience, and Massachusetts Bank Commissioner Pierre Jay legislative technical skill. These three were largely responsible for the bill enacted by the Massachusetts legislature of 1909, which became the first credit-union enabling act and the working model for credit-union legislation in the United States. Meanwhile, Desjardins had been putting his experience into practice in this country and started the first credit union in the United States, "La Caisse populaire Ste. Marie," in Manchester, New Hampshire.

The first stage of credit-union development covers the period from the enactment of the Massachusetts law in 1909 to 1921. During this period the preliminary research and publicity were prepared to launch the national credit-union movement.

President William Howard Taft gave impetus to the movement in the following letter (dated October 1, 1912) to the governors of all the states:

A very good law has been enacted by the State of Massachusetts allowing the incorporation of credit unions which should furnish an example to the other States. Their establishment is generally a matter of state legislation and encouragement, their organization and management wonderfully simple, as the European experience shows, and their success is practically inevitable when the environment is congenial and where proper laws are passed for their conduct.[4]

In 1912 President Taft sent a commission abroad to study Raiffeisen, Schulze-Delitzsch, and Luzzatti banks. One member of this commission, James Sprunt Hill, became so convinced of the value of what he learned that on his return to his home in North Carolina he drafted a credit-union bill, which was enacted in 1915.[5]

In the meantime, the Russell Sage Foundation had established a Division of Remedial Loans, largely as a result of a visit from Desjardins. The foundation promoted the drafting and enactment of the New York Credit Union Law in 1913. This bill replaced one for rural credits, which was withdrawn by its introducer, State Senator Franklin Delano Roosevelt.

Credit-union laws were enacted in Texas and Wisconsin in 1913; in Oregon, South Carolina, and Utah in 1915; and in Nebraska in 1919; but these could hardly be called enabling acts, since no credit unions had been formed in any of these states by 1921. By that time only four states had active credit unions—Massachusetts, Rhode Island, New York, and North Carolina—and the number of these totaled only 190 in all, with a membership of 72,310 and resources of $10,084,862.[6]

[4] Quoted, *ibid.*, p. 21.

[5] The North Carolina credit-union law, patterned largely after the Raiffeisen model, was designed primarily for rural groups. The Federal Farm Loan Act of 1916 was also influenced by the Raiffeisen plan for rural credits.

[6] Bergengren, *op. cit.*, p. 19.

The United States credit union assumed a form that was workable, although different from the European pattern, by 1921, when E. A. Filene and R. F. Bergengren formed the Credit Union National Extension Bureau in Boston. Unlimited liability had been abandoned, regular repayment of loans in instalments adopted, capital was obtained primarily from savings and deposits rather than by borrowing, and a higher rate of interest was charged on loans than in Europe. With the raising of rates, the credit union became an organization to serve the needs of persons primarily as consumers rather than as small producers.

In order to understand the American credit union of today this development must be traced a step further. Our modern needs have brought forth a type of organization unique in the world. The rapid rise of credit unions may be interpreted by viewing the increase in the demand for consumer loans, on the one hand, and, on the other hand, the organizational structure which has succeeded in attracting the required loan capital.

It is important to note that the first factor—the increase in demand for consumer credit—has resulted not only in the growth of credit unions but in an enormous expansion of consumer credit generally.

The development of consumer credit and the achievements of American technology are interrelated. Not only has consumer credit stimulated the distribution of certain products of high unit cost in relation to the average consumer's budget, but also the desire for these products has accelerated the development of consumer credit. Few of us are satisfied with the old-type icebox, for instance, for we have been convinced of the necessity of an electric refrigerator to our happiness and comfort. It has been the same

with automobiles, radios, and other expensive products of our era. The large majority of the people feel that such products must be bought "on time"; and, since the agencies selling them have become more and more reluctant to extend the necessary credit directly, consumer financing institutions, many of them largely owned by and working very closely with the merchandise agencies, have loomed larger and larger in the picture. On the radio any hour of any day can be heard living demonstrations of the important place credit companies have taken in our lives. Deferred payment was, indeed, an American habit until the wartime Federal Reserve regulations came along.

While the increase in demand for consumer credit has stimulated the growth of all types of consumer-loan agencies, the economies resulting from the credit-union form of organization have contributed to the fact that the rate of growth of credit unions during the last ten years has been more rapid than that of any other type of organization providing consumer credit, with the exception of the personal-loan departments of commercial banks.

The biggest cost involved in the issuance of consumer loans is the cost of credit investigation. Credit unions have reduced this cost below that borne by private loan agencies by various forms of membership limitations. Such membership limitations are usually encompassed by the requirement that the members have a "common bond." The significance of this common bond of membership is based on the assumption that the incentive to cheat one's peers is slight and that the honesty and ability to repay loans can more easily be ascertained in a group of colleagues than in a group of strangers.

In addition to the economies effected by membership restrictions, other credit-union savings result from the contribution of time and energy to management by members, favorable tax status, negligible advertising costs, and the donation of office space.

CREDIT UNIONS AND CO-OPERATIVES

The credit-union movement is but one aspect of the larger co-operative movement. The principal differences between the present American form of credit unions and European credit co-operatives have been indicated. Distinction should also be made between the principles of operation of American credit unions (which, unlike European credit co-operatives, do not render other than credit services to members) and the Rochdale principles of co-operation followed by consumer co-operatives in the United States.

For a century individuals have banded together in co-operative associations in an endeavor through collective action to better their individual economic standing as producers, bankers, and consumers. After a record replete with pitiable failures, the co-operative movement is now blossoming out in three main branches: (*a*) producers' and marketing co-operatives, (*b*) consumers' co-operatives and purchasing associations, and (*c*) credit unions.

Credit unions are co-operative associations designed to serve their members' thrift and loan needs. They qualify as co-operatives since they are voluntary associations of members, thus excluding compulsory copartnerships. As co-operative associations, "they must have as their aim mutual self-help with a view to some remote social goal of the participating social group; thus excluding commercial joint stock companies."[7] In working

[7] Grünfeld, "Credit Cooperation," *Encyclopaedia of the Social Sciences* (1931), IV, 555.

toward this social goal, credit unions operate under a form of business enterprise which differentiates them from farmers' unions, agricultural syndicates, and other forms of mutual-interest societies.[8] The central banking institutions set up by consumers' co-operatives are similar to commercial banks in function rather than to credit unions. Co-operative banks are designed primarily to serve the banking needs of their constituent member-societies.

In England, where the Rochdale principles were established, consumer loans are made through the consumer co-operative societies. In this country consumer co-operatives do not make loans to members; credit unions, however, are frequently formed among the members of co-operatives. For the good of co-operative credit, if not for the co-operative movement as a whole, it was probably wise to divorce the two types of co-operative institutions.

Both Rochdale co-operatives and credit unions are voluntary associations of individuals that seek to render services to themselves and to provide opportunities for savings. While consumer co-operatives are considered spurious if they do not open their membership to anyone regardless of occupation, race, creed, locality, or fraternal affiliations, the accepted principle for credit unions is to limit their membership to specified homogeneous groups. The reason for this difference becomes apparent upon realization of the fact that co-operatives usually sell goods and services for cash so that there are no problems of collection, whereas the purpose of credit unions is to issue credit and the main hazard is collection. It would be wrong to infer, however, that the credit-union movement is any less democratic than the consumer co-operative movement. Although each particular credit union may have qualifications for membership, individuals who do not qualify for one may always unite with persons with whom they have a "common bond" to form another.

Since the owners of a co-operative are its principal customers, the net income from operations is considered net savings from the point of view of the members. These net savings are distributed in two ways: a nominal rate of interest is first paid on members' shares, and the balance is then prorated equally on the basis of patronage—to nonmembers in shares and to members in cash. The distributed net income of a credit union is usually returned to the members on the basis of their shareholdings. A few credit unions in Ohio, Louisiana, and Washington, however, have returned part of their net income to borrowers in proportion to the amount of interest paid, and some consideration is now being given to the advisability of amending the Federal Credit Union Act to permit credit unions the option of declaring their net income on the basis of either shareholdings or patronage.

With respect to price policy, consumer co-operatives seek to sell at the market price, whereas credit-union loan rates are almost universally below the market price for small loans. With all due respect to the traditions behind co-operative principles, it seems quite clear that this one concerning market price cannot be reconciled with another announced goal—that of "trust-busting"—and that the latter can be attained only by rephrasing the co-operative price-policy objective as the *setting*, rather than the *meeting*, of the market price. It is common knowledge that the co-operatives in

[8] Somewhat similar in organization to credit unions but not classed in the general field of co-operative credit because of voting procedures are societies which render financial services of specialized types such as building and loan associations, burial funds, and mutual insurance societies.

Sweden have set the market price successfully in notable instances. An example in America is to be found in the sphere of influence of the Indiana Farm Bureau, where the price of fertilizer is significantly less than in contiguous areas. Credit unions are able to charge lower rates of interest than private lenders, largely, however, because of lower credit. Instalment loans, which comprised 21 per cent of the total of all instalment credit in 1929 increased to 49 per cent by the end of 1942 (Table 1). Instalment-sale credit reached a peak of $3,747 million in 1941 and dropped to $1,495 million by the end of 1942. Consumer instalment loans, after 1929, grew at a much faster rate than did sale credit.

TABLE 1

AMOUNT, INDEX, AND PERCENTAGE DISTRIBUTION OF CONSUMER INSTALMENT-SALE CREDIT AND LOANS, 1929–42

(Estimated Amounts Outstanding in Millions of Dollars)

End of Year	Consumer Instalment-Sale Credit*			Consumer Instalment Loans†			Total	
	Amount‡	Index	Percentage of Total	Amount‡	Index	Percentage of Total	Amount	Index
1929	$2,515	100	79	$ 652	100	21	$3,167	100
1930	2,032	80	75	674	103	25	2,706	85
1931	1,595	63	72	619	95	28	2,214	70
1932	999	40	66	516	79	34	1,515	48
1933	1,122	45	71	459	70	29	1,581	50
1934	1,317	52	71	529	81	29	1,846	58
1935	1,805	72	69	794	122	31	2,599	82
1936	2,436	97	70	1,030	158	30	3,466	109
1937	2,752	109	70	1,167	179	30	3,919	124
1938	2,313	92	65	1,226	188	35	3,539	112
1939	2,792	111	64	1,559	239	36	4,351	137
1940	3,450	137	63	1,984	304	37	5,434	172
1941	3,747	149	63	2,174	333	37	5,921	187
1942	1,495	59	51	1,428	219	49	2,923	92

* Including automotive, department stores, mail-order houses, furniture stores, household appliances, jewelry stores, all other retail stores.

† Including commercial banks, small-loan companies, industrial banking companies, credit unions, miscellaneous lenders, and repair and modernization loans.

‡ *Federal Reserve Bulletin*, April, 1943, p. 344.

costs of operation rather than because of any significant monopolistic elements in the consumer loan field.

THE QUANTITATIVE IMPORTANCE OF CREDIT UNIONS

Legislators have recognized the growing importance of credit unions by their speed in enacting enabling legislation, which will be discussed in a subsequent article. The success story of credit unions would be more striking were it not for the fact that credit unions issue a relatively insignificant part of instalment

The index of sale credit dropped from 149 to 59 between 1941 and 1942, whereas the index for loans did not drop proportionately so much—from 187 to 92.

The upward trend of instalment loans may indicate decreasing subsidization of credit customers of retail establishments by cash customers. Customers who cannot pay cash in full are more and more paying for their credit as a separate item. This should tend to reduce retailing markups and the practice of concealing the cost of granting credit in the retail price. Most merchants welcome the

growth of consumer instalment-sale credit and loans because a decline in "open" credit releases capital for use in merchandising operations.

Over the period 1929–41 all types of cash-lending institutions grew (Table 2). The personal-loan departments of commercial banks have expanded their operations much more rapidly than any other type of lending institution. According to the amounts of loans outstanding, the rate of growth of credit unions is second to that of the personal-loan departments of commercial banks. In 1939 credit unions surpassed in rank miscellaneous lenders, which includes unregulated lenders, pawnbrokers, axias, etc. While small-loan companies, industrial banks, and miscellaneous lenders lost ground percentage-wise to commercial banks and credit unions up to 1941, they dropped back proportionately less than the latter in 1942.

GROWTH OF CREDIT UNIONS

There are several factors by which to judge the growth of credit unions: membership, assets, income, dividends, and the size and amount of their loans—to name those most frequently used. The source of about 90 per cent of the capital of credit unions is the members' purchases of shares and their deposits. The balance is accumulated reserves of entrance fees, fines, and undistributed profits. The growth of the assets of credit unions arises out of the mutual interplay of a number of factors. The loan of capital yields income for dividends on shares. The profitability of credit unions attracts more share capital, which in turn permits granting larger and a greater number of loans. The knowledge of availability of loan capital and the record of dividends on shares and low percentage of bad debts attracts more members who are interested in both the possibilities of borrowing and a return on savings, etc. Since the first credit unions were organized in 1910, the spiral has been going continuously upward.

TABLE 2

ESTIMATED AMOUNTS OUTSTANDING IN CONSUMER INSTALMENT LOANS, 1929–42

(In Millions of Dollars)

End of Year	Total†	Commercial Banks‡	Small-Loan Companies	Industrial Banking Companies	Credit Unions	Miscellaneous Lenders
	Amount*					
1929...	$ 652	$ 43	$263	$219	$ 32	$ 95
1930...	674	45	287	219	31	93
1931...	619	39	289	184	29	78
1932...	516	31	257	143	27	58
1933...	459	29	232	121	27	50
1934...	502	39	246	125	32	60
1935...	617	71	267	156	44	79
1936...	790	130	301	191	66	102
1937...	1,004	215	350	221	93	125
1938...	1,054	248	346	230	113	117
1939...	1,315	380	435	257	147	96
1940...	1,667	586	505	288	189	99
1941...	1,839	687	535	298	217	102
1942...	1,228	370	424	202	141	91
	Percentage Distribution					
1929...	100	6.6	40.3	33.6	4.9	14.6
1930...	100	6.7	42.6	32.3	4.6	13.8
1931...	100	6.3	46.7	29.7	4.7	12.6
1932...	100	6.0	49.8	27.7	5.2	11.2
1933...	100	6.3	50.5	26.4	5.9	10.9
1934...	100	7.8	49.0	24.9	6.4	12.0
1935...	100	11.5	43.3	25.3	7.1	12.8
1936...	100	16.5	38.1	24.2	8.4	12.9
1937...	100	21.4	34.9	22.0	9.3	12.5
1938...	100	23.5	32.8	21.8	10.7	11.1
1939...	100	28.9	33.1	19.5	11.2	6.9
1940...	100	35.2	30.3	17.3	11.3	5.9
1941...	100	37.4	29.1	16.2	11.8	5.5
1942...	100	30.1	34.4	16.4	11.5	7.4
	Index					
1929...	100	100	100	100	100	100
1930...	103.4	104.7	109.1	99.5	96.9	97.9
1931...	94.9	90.7	109.9	84.0	90.6	82.1
1932...	79.1	72.1	97.7	65.3	84.4	61.1
1933...	70.4	67.4	88.2	55.3	84.4	52.6
1934...	77.0	90.7	93.5	57.1	100.0	63.2
1935...	94.6	165.1	101.5	71.2	137.5	83.2
1936...	121.2	302.3	114.4	87.2	206.3	107.4
1937...	154.0	500.0	133.1	100.9	290.6	131.6
1938...	161.7	576.7	131.6	105.0	353.1	123.2
1939...	201.7	883.7	165.4	117.4	459.4	101.1
1940...	255.7	1,362.8	192.0	131.5	590.6	104.2
1941...	282.1	1,597.7	203.4	136.1	678.1	107.4
1942...	188.3	860.5	161.2	92.2	440.6	95.8

* *Federal Reserve Bulletin*, April, 1943, p. 344.

† The totals for the years 1934–42 are smaller than the corresponding figures in Table 1 by the amount of repair and modernization loans.

‡ These figures include only personal instalment cash loans and retail automotive direct loans and a small amount of other retail direct loans but exclude purchased automotive retail instalment paper, other retail purchased paper and direct loans, and repair and modernization loans.

Table 3 sets forth the steady and parallel growth of five indices of credit-union development—number of states having legislation, number, membership, assets, and loans of credit unions.

The number of credit unions and the membership have increased consistently in each period since 1910. Total assets dropped slightly from 1929 to 1932, even though the membership was increasing, as wage cuts and unemployment forced members to reduce their share balances. In absolute terms the growth of credit unions was most marked between 1933 and 1942.

TABLE 3

LAWS, NUMBER, MEMBERSHIP, ASSETS, AND LOANS OF ACTIVE CREDIT UNIONS
1910–42

Year	Number of Laws	Number of Credit Unions	Membership (In Thousands)	Assets (In Thousands)	Loans Made (In Thousands)
1910*...	1	2	0.1	$ 2	.....
1915†...	9	48	8.0	471	.....
1920†...	10	142	40.0	3,568	.....
1925†...	24	419	219.0	21,165	.....
1930‡...	32	1,099	302.0	37,675	.....
1931‡...	35	1,300	320.0	36,553	.....
1932‡...	36	1,555	335.0	35,556	.....
1933‡...	39	1,929	404.0	36,965	.....
1934‡...	40	2,431	539.0	44,359	.....
1935‡...	43	3,800	822.0	59,507	.....
1936‡...	43	5,352	1,170.0	83,071	$100,200
1937‡...	43	6,292	1,588.0	115,399	147,210
1938‡...	43	7,314	1,927.0	147,156	180,848
1939‡...	44	8,326	2,405.0	192,724	238,903
1940‡...	44	9,479	2,816.0	252,293	306,093
1941‡...	45	10,425	3,532.0	322,515	362,779
1942§...	45	.....	.....	.....	215,000

* J. L. Snider, *Credit Unions in Massachusetts* (Cambridge: Harvard University Press, 1940).

† Rolf Nugent, *Credit Union Primer* (New York: Russell Sage Foundation, 1930).

‡ Federal Deposit Insurance Corporation, unpublished data.

§ *Federal Reserve Bulletin*, April, 1943.

EFFECT OF THE WAR

Credit unions have, of course, felt the effect of the war. Federal Reserve Board Regulation W, curtailment in the production of durable goods, and increased incomes have decreased the amount of credit-union loan business, while increasing the amount of savings placed in shareholdings. As a result, dividend payments have been almost invariably smaller and in some cases eliminated.

The migration of workers from peace to war plants and into the Army resulted in a decrease in the number of credit-union members and in the number of active credit unions during 1942. Credit unions in most industries have suffered because of the heavy turnover among officials, paid personnel as well as members.

A considerable number of the weaker credit unions have liquidated. Most of these liquidations have been voluntary, and it is noteworthy that losses to members have been rare. In the first three months of 1943, for example, the 53 federal credit-union liquidations more than offset the 41 new applications for charters. Seventy-five per cent of the liquidated credit unions held shares totaling less than $2,000, and only one had reached $10,000. Forty-four of the 53 paid their members on the average $1.08 for each dollar held in shares. The remaining 9 failed to return the full value of shares to members. These 9, with share accounts totaling $7,392 at the beginning of liquidation, returned only $4,707 to members, making a loss of $2,685. The over-all picture is that the 53 liquidating federal credit unions with shares of $96,596.54 at the beginning of liquidation paid to members, before cancellation of charters, $100,838.58.

According to Mr. Orchard:

> The conclusion could be drawn from experiences to date that the group which begins a credit union will be able to pay out all shareholders providing they operate for a year or more, accumulate a thousand dollars, loan it, and then are blessed with honest officials who use reasonably good judgment.[9]

[9] C. R. Orchard, special assistant to the Board of Directors, Federal Deposit Insurance Corporation, in an address to the Illinois Credit Union League, April 10, 1943.

THE CREDIT-UNION LEGAL FRAMEWORK. II*

LINCOLN CLARK

INTRODUCTION

TO ORGANIZE a credit union, legislative sanction is required. Statutory provision is necessary to avoid running afoul of usury laws, on the one hand, and, on the other, state banking provisions regarding the acceptance of savings. Moreover, since credit unions combine the functions of savings banks and small-loan agencies and are unlike either of these in character of organization, special enabling legislation for their operation is required.

At the present time forty-five credit-union laws have been passed, including the District of Columbia law and the federal law. Since the enactment of the Federal Credit Union Act (F.C.U.A.) in 1934, credit unions can be organized anywhere in the United States and its possessions. There is much similarity among the several laws, since most of them have been patterned after the Uniform Credit Union Law, as drafted by R. F. Bergengren, managing director of the Credit Union National Association. It is probably safe to say that, in the past, variations from the provisions of the Uniform Credit Union Law have been factors in impeding the development of credit unions in several states. At present one of the first problems confronting a group contemplating the organization of a credit union is the choice between state and federal charters. The rapid development of federal credit unions, which at the end of 1941 comprised 46 per cent of the 10,425 credit unions operating in the United States, indicates that the F.C.U.A. has superseded in importance the various state laws embodying the Uniform Credit Union Law. For this reason the provisions of the F.C.U.A. are analyzed in detail. The article concludes with a discussion of some of the principal characteristics of the several state acts.

* This is the second of two articles on credit unions; the first appeared in the October, 1943, issue.

THE FEDERAL CREDIT UNION ACT

The large number of federally chartered credit unions, 4,793, is rather remarkable, considering that the F.C.U.A. was approved June 26, 1934. Senator Morris Sheppard of Texas sponsored S. 1639:

> An Act to establish a Federal Credit Union System, to establish a further market for securities of the United States and to make more available to people of small means credit for provident purposes through a national system of cooperative credit, thereby helping to stabilize the credit structure of the United States.[10]

That the objective of making credit available is being realized is demonstrated by the record of federal credit-union growth; loans made in 1936 totaled $15,658,000; in 1941, $134,332,000. There was some question at an earlier date as to whether the aim "to establish a further market for securities of the United States" would ever be realized in any great measure. By the end of 1939 only 2 per cent of federal credit-union assets were in United States government bonds.

[10] Farm Credit Administration, *The Federal Credit Union Act as Amended to June 16, 1938* (Washington: Government Printing Office, 1938)

During the course of the war, however, credit unions have felt the effect of consumer credit regulations, of increased and more remunerative employment, and of the decrease in production of consumer durable goods. As a result they have begun to accumulate an excess of funds not needed by their borrowing members. At the end of 1942, out of total assets of $116,000,000, federal credit unions had $29,000,000, or 25 per cent, in government bonds. In addition, federal credit unions reported the sale of War Bonds amounting to over $67,000,000 at the end of 1942. The Treasury Department reports that on March 15, 1943, there were 2,876 "issuing agent" credit unions.

A credit union is defined in the act as a co-operative association organized to promote thrift among its members, by affording them a source of credit for loans for provident or productive purposes. The federal act is not alone in reversing the order of the functions of a credit union in the definition. It is a common failing in all credit-union literature to place the function of savings before that of credit and to overlook the meaning of the name—*credit union*—and the fact that the purpose of soliciting savings is *primarily* to accumulate capital for loans. The savings or thrift aspect of credit unions is, of course, an admirable by-product, and from testimonials by some new members of credit unions it appears that some of the accumulated assets represent capital that would, except for the efforts of the credit union, not have been saved.

ORGANIZATION

The F.C.U.A. was originally administered by the governor of the Farm Credit Administration. By Executive Order No. 9148 of April 27, 1942, however, the chartering, examination, and supervision of federal credit unions was transferred to the Federal Deposit Insurance Corporation.

A minimum number of seven persons having a common bond of occupation or association or living within a well-defined neighborhood, community, or rural district, upon raising at least $20 may sign an "organization certificate" and submit this, with the proposed by-laws, as an application for a federal credit-union charter. The F.D.I.C. retains the $20 fee to defray the cost of investigating the prospective credit union. The need for investigation is less to protect prospective members from dishonest promoters than to try to determine whether the character and fitness of the original subscribers are such as to promise successful operation of the credit union. Some credit-union promoters, though fired with enthusiasm for organization, have not given sufficient consideration to the everyday problems of management. For example, the F.D.I.C. recommends that there be a potential membership of at least one hundred persons. If the potential field is much smaller, the problem of accumulating sufficient loan capital is too great, and the per capita expense of organization and operation is likely to be too high for efficient operation. Another important factor in forecasting credit-union success is the degree of the "common bond" of the members.

The probability of success of a credit union which anyone can join—the so-called "open-membership" type—is not very good because of the limitation of a 1 per cent per month rate of interest on loans. Open-membership credit unions have had a dismal record, largely because this rate is insufficient to cover the costs of credit investigation of new mem-

bers and collection of loans from disloyal members.

Upon approval of the organization certificate and the by-laws by the F.D.I.C., an additional fee of $5.00 must be paid for the right to operate. The original subscribers then convene and elect from among themselves a board of directors, a credit committee, and a supervisory committee. The chosen board of directors elects the officers from its number. The board and committee members elected at this organization meeting serve until the first annual general membership meeting, when their successors are elected.

The new credit union is now ready to begin operations. The first task is to secure capital with which to make loans. The principal source of such capital is membership shares.

Membership and capital.—Eligibility for membership is decided by majority vote of the board of directors. Each applicant must be a member of the group having a common bond of association, occupation, or residence and have a personal character indorsement of a director. The applicant is then admitted to membership upon payment of an entrance fee of 25 cents and a subscription for at least one share in the credit union. The par value of all federal credit-union shares is $5.00, and they may be bought in instalments of as little as 25 cents. Thus it is provided that there shall be no financial barriers to becoming a member. The maximum number of shares which may be held by any one person is fixed from time to time by the Board of Directors. A common intracredit-union debate is related to the size of this limit. With an exceedingly high limit a credit union may become financially dependent on a small group of shareholders whose views may carry more influence than their numerical number of votes. Their power arises from possible threats to withdraw their capital. If the limit is too low, however, the incentive to save in the credit union is weakened. Higher limits may bring in more capital, thus permitting the dividends on shares to be reduced unless this added capital is wanted for loans.

Members are not permitted to sell their shares freely but may transfer them to other members (upon payment of a 25-cent fee) or turn them in for redemption. In the latter case the member is entitled to the par value plus any interest accumulations, but the board of directors of credit unions, like those of many savings banks, may at any time require 60 days' notice of intention to redeem shares.

The other methods used to secure capital are borrowing and discounting. Federal credit unions are empowered to borrow from any source up to 50 per cent of their paid-in and unimpaired capital and surplus. They may discount or sell eligible obligations through any federal intermediate credit bank. The federal government neither loans nor gives money to credit unions. The only financial transactions between federal credit unions and agencies of the federal government are the discounting of eligible paper and the payment of fees to the F.D.I.C.

Loans.—Application for a loan "for a provident or productive purpose" is passed upon by the credit committee. Character loans may be made up to $100 without any further security than the member's signature. Like other lending organizations, credit unions may make larger loans to applicants whose character is backed with more tangible security. The most common form of security, however, is the indorsement of the loan by one or more persons. (No credit-union

officer may indorse a member's loan.) The maximum for loans is $200, or 10 per cent of the paid-in capital and surplus, whichever is greater. Loans may be repaid in instalments (usually at regular intervals). Maturities may not exceed 2 years (of course, wartime consumer-credit regulations control this). In the interest of unprejudiced handling of capital, loans to a director, officer, or member of a committee may not exceed the amount of his shareholdings.[11]

Interest rate.—The increasing popularity of credit unions may be attributed largely to the relatively low rate of interest charged on loans. The F.C.U.A. limits the interest rate to 1 per cent a month on unpaid balances, inclusive of all costs incident to making the loan. Frequently critics who have never had to borrow from a "small-loan" agency, observing that 1 per cent a month is equivalent to 12 per cent per annum, remark that this is substantially more than the common commercial bank loan rate of 5 or 6 per cent, or the insurance policy rate of 4–6 per cent. Obviously, persons in a position to get small loans at lower than credit-union rates should do so. The function of credit unions is to serve persons who are unable to secure loans from banks and whose alternative is to patronize a pawnbroker or small-loan company charging 18–42 per cent interest per annum.

Dividends.—Borrowers as well as nonborrowers benefit from the profits of a credit union. After expenses have been paid and 20 per cent of the net earnings have been placed in the reserve fund for possible bad loans, the remaining funds may be distributed to the members. Dividends up to 6 per cent are authorized by the general membership, upon the recommendation of the board of directors, at the annual meeting and are distributed in proportion to the number of shares held by each member. As has been noted previously, it is in the method of distribution of net receipts that credit unions depart from the accepted Rochdale principles of co-operation. Since the primary justification of a credit union is to aid borrowers rather than serve as a profit-making enterprise for borrowers, the proposed amendment to the F.C.U.A., to give the membership the option of whether to distribute profits in ratio to shares or partly in ratio to interest paid on loans, holds considerable merit.

Investments.—When the savings of members in a credit union exceed their loan requirements, many alternative methods of disposing of the surplus are available. If the surplus remains idle, the dividends on shares necessarily will have to go down. On occasion the situation has been met by reducing the limit on shareholdings. During the war, credit unions have, as previously noted, increasingly invested their surplus capital in War Bonds. Other permitted investments are securities fully guaranteed as to principal and interest by the government or shares of federal savings and loan associations.

A large field for expansion lies in loans to other credit unions, which may be made up to 25 per cent of paid-in and unimpaired capital and surplus. At the present time most credit unions have surpluses; after the war some credit unions will have surpluses, while others will be short of capital. A credit union that maintains equilibrium between its supply of loan capital and the demand for it is the exception to the rule. Credit unions are permitted few opportunities to invest their reserves where more than

[11] In several regions of the country, credit-union officials have formed their own credit unions to take care of their loan requirements.

the nominal yield of government securities can be obtained. On the other hand, credit unions often have difficulty in borrowing from commercial sources. Aside from the point that some credit-union leaders feel a moral obligation to help out other credit unions in whatever way needed, loans to other credit unions could be made that would carry negligible risks and return a much higher yield than that obtainable on government securities; at the same time the recipient credit unions would benefit by loans carrying lower interest rates than those available in the commercial market. Central credit unions have been formed already in Iowa, Missouri, and Minnesota to facilitate inter-credit-union financial transactions.

MANAGEMENT

One of the secrets of credit-union success lies in their simplicity of organization and ease of management. The F.C.U.A. and its suggested by-laws are noteworthy for their clarity and completeness. In the first place, there is the legal requirement of a "common bond" between the members, which results in low credit investigation and collection costs; second, there is the harnessing of members' services for management.

The members elect from their membership those who will have the responsibility and honor of managing the affairs of the credit union. Each member is entitled to one vote irrespective of the number of shares he owns; proxy voting is prohibited. The board of directors, elected by and from the membership, is composed of not less than five members. The directors elect from their number a president, vice-president, clerk, and treasurer. The last two offices may be, and often are, held by the same person. Because the treasurer's duties involve much time-consuming detail work, this is usually the only paid position. The board must meet at least once a month to act upon applications for membership; fix the amount and character of the surety bond for officers having custody of funds; recommend the declaration of dividends to the general membership; fill vacancies in their own board or on the credit committee, until successors are elected at the next general membership meeting; direct investments (other than loans to members); determine the maximum number of shares that a single member may own; determine the rate of interest on loans below the 1 per cent permitted by law; and set the limits on maximum amount of loans within the limits legally authorized.

The group most in evidence is the credit committee, composed of at least three members, which acts on loan applications. Loans are not made unless approved by a majority of the committee and unanimously by the members of the committee present at the meeting when the loan application is discussed. Formerly, no loan over $50 could be made without security. On June 15, 1940, the F.C.U.A. was amended to increase the limit for unsecured loans to $100. That this was warranted is evidenced by the record, which shows only 0.07 per cent of total loans made by all federal credit unions as having been charged off as bad debts by the end of 1941. This represented $289,967 out of $400,651,000 granted in 3,807,000 loans since the organization of the 4,144 credit unions reporting on December 31, 1941.[12] Secured loans may be made up to $200 or 10 per cent of the credit union's paid-in and unim-

[12] During the year 1941, 1,038,000 loans were made, totaling more then $134,000,000. The average size of loans increased steadily from $42 in 1934 to $129 in 1941.

paired capital and surplus, whichever is greater.

In addition to a board of directors, a credit committee, and sometimes an education committee, each federal credit union has a supervisory committee, in which is invested considerable power. This committee is usually made up of "elder statesmen," who watch for any deviations from sound management procedures. Besides auditing the books at least quarterly and reporting on the condition of the credit union at the annual meeting, the supervisory committee has the power, by unanimous vote, to suspend until the next membership meeting any director, officer, or member of the credit committee. In the event of such suspension, the supervisory committee is required to call a general membership meeting within a week to consider the action.

GOVERNMENTAL SUPERVISION

In addition to the watchful eye of the supervisory committee, the members are further protected against mismanagement by the supervision of the F.D.I.C. Annual reports of all federal credit unions must be sent to this organization, which also periodically sends out agents to audit their books. The corporation sets the scale of examination fees, which at present is 25¢ per $100.00 of assets or cost, whichever is lower, with a minimum fee of $2.50. The fees go into a special government account to defray the costs of administering the F.C.U.A.

Federal credit unions are no more autonomous than private national banks and are just as inclined to chafe under and complain about governmental red tape, rules, and regulations. Governmental supervision is probably of greater value to credit unions than to national banks, however, since the former are not directed by professional bankers. By standardizing reports, methods, procedures, and forms, the government can accelerate the training period of a new treasurer by providing him with a model set of records; it can advise on the problem of attracting and educating members; it can cut the cost of auditing; it can supply a central research agency; it can advise directors on their problems; and it can provide the members with greater protection against mismanagement by forewarning if operations appear abnormal.

Taxation.—Taxation of credit unions is a subject in which there is widespread interest and concerning which many sweeping and sometimes inaccurate statements are made. The real or tangible property owned by federal credit unions may be taxed to the same extent as any other similar property. Congress specifically exempted federal credit unions from federal, state, territorial, or local taxation of their franchises, capital, reserves, surplus, and income.

COMPARISON BETWEEN STATE AND FEDERAL LAWS

Not only is the F.C.U.A. more recent than most credit-union laws but since its enactment it has been used more extensively than the state laws. A group contemplating the organization of a credit union is immediately confronted with the problem of choosing between a state and a federal charter. The following analysis of the several state laws should help indicate whether a state or a federal charter is preferable for individual groups and may also indicate desirable amendments to the federal law and to the state laws.

Massachusetts passed the first credit-union law in 1909; and the forty-fifth law was passed in 1941 in its neighboring

state, Vermont. At the end of 1941 there were more state- than federal-chartered credit unions, 5,509 as against 4,144, but the lead has been diminishing (Table 4). While the 4,144 federal credit unions had been established in the period 1934–41, the net increase in the number of state-chartered credit unions in this period was only 3,580.

There is no problem in choosing a charter in those states which have not enacted credit-union laws—Delaware, Nevada, New Mexico, Wyoming, and Maine.[13] In each of these states credit unions are operating under federal charters. The fact that the Connecticut and Vermont laws have not yet been used may be explained by the short passage of time since their enactment in 1939 and 1941, respectively. Although the South Carolina law was passed in 1915, all the credit unions chartered under it have transferred to federal charters. One stipulation in this law—that the interest rate on loans may not exceed 7 per cent per annum—is enough to prevent successful operation.[14]

While the relative popularity of the federal and state laws since 1934 is shown in Table 4, the conclusion should not be necessarily drawn that the more popular law is the better for a particular group. While relative popularity is a helpful guide in choosing a charter, such other factors as the following should also be considered: special features for particular occupational groups; the relative popularity of charters in the particular locality within the state; the ability, availability, and inclinations of local credit-union leaders; the attitude and helpfulness of state supervisory officials; the relative amount of organization, recording, and filing fees; the comparative cost and quality of examination of the financial records; relative provisions for unsecured and secured loans; provisions for deposit accounts; and the importance of securing loan capital from other credit unions.

Space does not permit full discussion of each of the laws in the above respects. A few special provisions may be worthy of note in addition to the summary in Table 5 (p. 64).

For example, Pennsylvania requires a $30 payment for amendments to a charter. Formerly credit unions under the Arizona law had to pay corporation organization fees which were prohibitively high. The District of Columbia commissioners have followed the practice of approving applications for charters from groups within the organized labor movement primarily, with apparent disregard of the law, which stipulates that any group having a common bond of occupation or association or residence within a well-defined neighborhood or community is entitled to participate in the credit-union movement.

The 1938 revisions of the New Jersey law have lessened restrictions for acceptable security for loans, but for legally prescribed details of procedure and operation, which sometimes seem picayune, to say the least, the New Jersey law is surpassed only by the Connecticut law of 1939.

The West Virginia and Virginia credit-union laws are much less desirable than the federal law from the point of view of borrowers. The legal maximum rate of interest on loans is $1\frac{1}{2}$ per cent per month as contrasted to the federal 1 per cent

[13] The Maine legislature, however, has granted special permission to operate to three co-operative credit associations.

[14] Lack of co-operation on the part of the office of the secretary of state may be a contributory factor. Bergengren did not succeed in securing much information on the South Carolina law and its administration for his book, and the writer's inquiries remain unanswered.

TABLE 4

NUMBER OF STATE- AND FEDERAL-CHARTERED CREDIT UNIONS, BY STATES*

State	Year Law Passed	State and Federal (End of 1941)	Federal-chartered (1934–41)	State-chartered (1934–41)	Ratio Federal- to State-chartered (1934–41)
Alabama	1927	87	22	40	0.55
Arizona	1929	22	18	2	9.00
Arkansas	1931	35	13	16	0.81
California	1927	457	295	114	2.59
Colorado	1931	106	51	44	1.16
Connecticut	1939	190	190	.....	.....
Delaware	†	11	11	.....	.....
District of Columbia	1932	115	90	15	6.00
Florida	1929	178	103	66	1.56
Georgia	1925	145	41	40	1.03
Hawaii	.....	93	93	.....	.....
Idaho	1935	39	32	7	4.57
Illinois	1925	831	119	582	0.20
Indiana	1923	310	169	35	4.83
Iowa	1925	212	5	103	0.05
Kansas	1929	132	28	82	0.30
Kentucky	1922	124	10	82	0.10
Louisiana	1924	122	92	14	6.60
Maine	†	37	34	.....	.....
Maryland	1929	72	33	27	1.20
Massachusetts	1909	547	81	184	0.40
Michigan	1925	261	90	131	0.70
Minnesota	1925	373	25	203	0.10
Mississippi	1924	22	16	3	5.33
Missouri	1927	386	29	225	0.13
Montana	1929	37	30	4	7.50
Nebraska	1919	208	30	136	0.22
Nevada	†	6	6	.....	.....
New Hampshire	1921	18	8	3	2.67
New Jersey	1924	250	194	30	6.47
New Mexico	†	10	10	.....	.....
New York	1913	805	567	108	5.25
North Carolina	1915	172	22	92	0.24
North Dakota	1935	88	34	54	0.63
Ohio	1931	654	294	334	0.88
Oklahoma	1933	89	43	36	1.19
Oregon	1915	77	44	28	1.57
Pennsylvania	1933	604	512	67	7.64
Rhode Island	1914	33	10	10	1.00
South Carolina	1915	44	41	3	.....
South Dakota	1935	34	34	.....	.....
Tennessee	1923	136	61	18	3.39
Texas	1913	388	298	47	6.34
Utah	1915	62	18	36	0.50
Vermont	1941	5	5	.....	.....
Virginia	1922	101	68	6	11.33
Washington	1933	236	56	170	0.33
West Virginia	1925	71	49	10	4.90
Wisconsin	1913	600	1	398	0.00+
Wyoming	†	18	18	.....	.....
United States total	.....	9,653	4,144	3,580	1.16

* Unpublished in the F.D.I.C.

† No credit-union law has been passed in this state.

limit. Furthermore, the organization, examination, and annual fees are higher than those charged under the F.C.U.A.

The Ohio law is unique in that the basis on which to declare dividends is not stipulated. This has been utilized by some credit unions to declare part of their net savings in the form of patronage rebates to borrowers in proportion to the amount of interest paid on loans rather than on the basis of their shareholdings. The state supervisory officials in Ohio, as well as in Michigan and Illinois, are noted for their helpfulness to credit unions.

While the provision had not been used as of January 28, 1940, the Washington law is alone in specifically providing that "surplus earnings may be distributed to the borrowers as a patronage dividend ratably in proportion to interest paid by them."

Credit unions are known as "co-operative credit associations" in Nebraska and are of two types. One type is for "bankless towns" and the other for "fixed groups." Those formed by fixed groups operate in the customary credit-union fashion. Those in bankless towns act, in a sense, as substitutes for commercial banks. Members issue "assignments" of their deposits, which are used as a medium of exchange. Although these assignments are not negotiable instruments under Nebraska law, they have become generally accepted by commercial banks after an initial period of vigorous opposition.

The relative prominence of state-chartered over federal credit unions in Illinois is due to such factors as an exceedingly able supervisor in the state auditor's office, lower costs of securing a charter, a higher unsecured loan limit, and vigorous, albeit conservative, promotion on the part of the leaders in the Illinois credit-union movement, who freely inveigh against the "red tape" involved in operating under a federal charter. The Illinois law contains a violation of co-operative principles, which, however, probably has not been a factor in the growth of Illinois credit unions. Whereas the "one member–one vote" rule prevails in each of the other forty-four credit-union laws, the Illinois law, owing to a constitutional requirement, specifies that in the election of directors voting shall be on the basis of "one share–one vote."

Unsecured loans.—From the point of view of borrowers, the most important provisions of a credit-union law are the limits on unsecured and secured loans and the rate of interest permitted. The higher the unsecured loan limit, the easier it is to secure a loan without the trouble and embarrassment of securing cosigners. The most common limit on unsecured loans is $50, six states permit $100, three specify $300, and in Utah the limit is $500. That the $50 limit restricts the usefulness of credit unions and that a higher maximum is safe is suggested by the amendment to the F.C.U.A. in 1940, raising the unsecured loan limit to $100.

Since legal limits on the size of loans are permissive rather than mandatory, it might seem that the most liberal type of provision is that which permits the directors to set the limits. In actuality, however, a major credit-union problem is how to loosen up overly cautious directors who profess to play safe with the assets by holding limits down. The directors do not interview the loan applicants, do not know the purpose for which a loan is sought, the borrower's past repayment record, or his ability to pay. The approval of loans is the special function of the credit committee, on which directors are usually prohibited from sitting. Hence their mistrust arises from ignorance and

is probably without foundation. Credit unions could increase their field of service without unduly jeopardizing assets if the limit on unsecured loans were arbitrarily set at 10 per cent of the paid-in capital and surplus, or $300, whichever is less. Such a rule would guarantee a reasonable diversification of risk for small credit unions and would place those which have accumulated assets of $3,000 or more in competitive equality with private small-loan companies.

One effect of the higher limit on unsecured loans would be to relieve cosigners to a greater extent. Too often a member when asked to sign a friend's loan application does not realize the financial liability he is incurring. Even if he is aware that thereby he assumes liability for the repayment of the loan in case the borrower defaults, he is likely to overlook this consideration in the face of the pressure of his fellow-member's financial distress.

The ideal solution would require a borrower whose credit rating does not justify an unsecured loan or whose application exceeds the unsecured loan limit to secure a dozen or more cosigners so that in the event of default the loss would be shared by many rather than by only one or two members. Recognizing that such a procedure is not administratively feasible, the logical solution is to extend the distribution of risk even further by delegating more authority to the credit committee to determine the amount of credit to be extended to its borrowers on unsecured loans. From interviews with borrowers and members of credit committees the writer has received the definite impression that credit unions are unnecessarily stringent in their loan requirements. Greater liberality would redound further to the reputation of credit unions for fulfilling a worthy function. The weapon of publicity might be used as a safeguard against dishonest borrowers as contrasted to borrowers who are financially unable to pay. Credit unions have a decided advantage over private loan companies in that members, if informed of delinquent borrowers, can and will exert pressure on laggards in order to safeguard their own savings.

Secured loans.—There is no "right" figure for the maximum amount of secured loans, and, just as in the case of unsecured loans, there is considerable disparity in the limits. The maximums range from the Oregon limit of $100 or 10 per cent of the assets, whichever is greater, to $4,000 in Massachusetts. Liberty is allowed the directors in twenty states to set the limits on the theory that they know best the risks involved. In practice, as with unsecured loans, this freedom is often meaningless since credit-union directors are seldom experienced in determining credit-union risks. A legal monetary limit serves as a useful guide to directors, yet one which may be disregarded in favor of a lower limit if they feel it endangers the financial structure of their credit unions.

Because of the risks involved due to changing market values, loss of liquidity of investment, and unfortunate experience (particularly in Massachusetts), credit unions are seldom permitted to make long-term real estate loans. Automotive loans are among the safest that credit unions can make because of the marketability of secondhand cars. The Louisiana limit of $500 or 10 per cent of the assets, whichever is greater, appears to be a reasonable provision. This limit permits a small credit union to make automotive loans and yet circumscribes the limit of possible loss when assets exceed

$5,000. Such a rule would permit credit unions to compete fairly with automobile finance companies.

Deposits versus shares.—The interests of members of credit unions as borrowers are primarily in loan requirements and rates; as savers they are most interested in the security of their savings and the rate of interest paid on them. In addition to shares, provision is made in thirty-one states for the acceptance of deposits which are held in separate accounts from the share accounts and on which a lower rate of interest is usually paid. Commonly the purchase of at least one share of stock is obligatory to qualify for membership. Thereafter, members have voting rights, the privilege of purchasing more shares, the right to apply for loans, and permission to establish deposit accounts with the credit union. In a few cases deposits may be accepted from nonmembers, but the latter may not vote or borrow. Shares receive a dividend determined according to earnings and the general financial condition of the credit union. Deposits, on the other hand, are paid a fixed preannounced rate of interest.

It is frequently stated that the function of the share account is to hold that part of the members' savings which they desire, as far as possible, to leave permanently undisturbed and to which they hope to add from year to year. The function of the deposit account, however, it is argued, is to serve as a repository for sums which may have to be withdrawn in the course of a few months. The differentiation is reflected in credit-union by-laws which provide that sixty-day notice may be required for the withdrawal of shares, but only thirty-day notice need be required for the withdrawal of deposits.

The more active an account is, the more work it demands. Consequently, credit unions have been advised to segregate "in and out" accounts into deposit rather than share accounts so that the servicing cost can be covered by a lower rate of interest. A reasonable return on deposit accounts is 3 per cent, but a credit union borrowing from outside sources usually has to pay 4–6 per cent. Therefore, there is a profit incentive to secure additional capital by encouraging deposit accounts. Moreover, deposit-account holders will accept a lower rate of interest than that paid on shares because, in the event of liquidation, deposits have a lien on the assets prior to shares.

While deposit accounts may appear convenient to segregate expensive in-and-out accounts and to secure low-cost capital, there are definite drawbacks to their use. In the first place, the establishment of preferred creditors may diminish the members' concern for the welfare of their credit union. Members with deposits much larger than their shareholdings are likely to sit back with a feeling of assurance that their equity is safe and leave the management to others. It must be remembered that credit unions depend largely for their success on the voluntary participation of the membership in the business of the union.

Looking at the matter from another point of view, an innocent prospective depositor might be lured to a false sense of security by a board of directors too aggressive in soliciting capital. If safety is the depositor's primary concern, he would be much better off by placing his funds in savings banks, the deposits of which are insured by the F.D.I.C. Federal credit unions do not have deposit accounts, and the F.D.I.C. does not in-

sure shares in credit unions any more than the shares in banks.

Even the argument that deposit accounts cost more than share accounts and are therefore entitled to a lower rate of return is open to question. Credit unions are often termed "poor men's banks" which encourage regular saving. These savings are accepted as deposits or applied on shares in amounts as low as 25 cents. Both forms of transaction require an equal amount of work. Obviously, then, the objectionable higher costs of active deposit accounts would have to be in the taking-out rather than in the putting-in of money. This administrative problem, however, can be neatly solved by the use of passbooks, such as those used by all federal credit unions, in which each instalment on the purchase of a share is entered. In the adjoining column withdrawals are entered, and in a third column the balance is indicated. By this method all savings and withdrawals are recorded in a single account. Therefore, it is seen that the treasurer's job is less when transactions are lumped than when it is necessary to maintain separate deposit and share accounts.

Examination fees.—There is no uniformity whatsoever in the method of charging for the examination of credit-union books. Some laws provide that the fees be the "actual cost" to the supervisory agency, others are on a per hour or per diem basis, some establish a flat fee, and still others stipulate a certain percentage of the total assets. If the law specifies that the supervisory agency shall charge "actual cost," the dilemma arises of how to prorate departmental overhead or to charge each examined credit union that marginal amount directly attributable to the examination. If only the directly attributable cost is charged, the supervisory agency may, for lack of funds, be prevented from performing other than strictly auditing services. Yet if the actual cost is too high, the expenses may be a severe burden to young, small credit unions. The method of fixing fees as a percentage of the credit union's assets appears justified as a rough approximation of its ability to pay. It has the added merit of subsidizing new struggling credit unions at the expense of the established larger credit unions. Thus, the subsidy received in the early years of a credit union in the form of low examination fees tends to be repaid in later years as the credit union grows.

THE DUAL CREDIT-UNION SYSTEM

In forty-three states credit unions can choose between state and federal regulation before incorporation and, later, if it is found advisable, dissolve and switch from one to the other. The choice depends on whichever of the two laws appears to be more liberal to the members. Neifeld expresses the view that

> this makes for competition between the federal statute and the state statutes. There is no real advantage in having two systems. The Federal Law should be amended to include the safeguards suggested. . . . . After satisfactory experience under the Federal Law, the several states should abolish the local credit union laws.[15]

Disregarding the old question of "states' rights" and the political difficulty of abolishing the state laws and confining the large question of national versus state incorporation of economic enterprises to credit unions, there appear to be many advantages to the dual system. Writing a law for credit unions that would serve the needs of and satisfy all local groups all over the country after the

[15] M. R. Neifeld, *Cooperative Consumer Credit, with Special Reference to Credit Unions* (New York: Harper & Bros., 1936), p. 174.

relatively short experience and life of the credit-union movement would be an overwhelming task. It would surely be much more difficult, for example, than to write a national law for state savings or commercial banks that would result in relinquishment of state charters except under duress; and yet lawyers have been writing banking legislation for many decades.

Standardization should not be forced unless the gains far outweigh the disadvantages. The omnipresent difficulty in complete standardization is to determine the best standard at a given moment which can apply over a period of time. To obtain better statutes there is virtue in having the different states serve as legislative guinea pigs. In working toward the goal of reducing the costs of supervision and administration, it is salutary to experiment with different methods of making examinations and keeping records. And, lastly, from the point of view of securing sympathetic supervision, there is advantage in permitting credit unions the choice of supervision both for initial charters and for transfers. The author believes that many years will pass before a single federal law and administration would have sufficient advantages over the present system to warrant the repeal of the forty-three state credit-union acts.

TABLE 5

SELECTED PROVISIONS OF CREDIT-UNION LAWS AND BY-LAWS OF 1939

State	Year Enacted and Last Amended	Deposit Accounts	Maximum Interest Rate	Maximum Unsecured Loan	Maximum Secured Loan	Maximum Value of Shares	Organization, Recording, Filing, Fees	Examination Provisions and Fees	Taxation, Annual Fees
Ala.	1927	Yes	1% per mo.	Set in by-laws	Set in by-laws	$10	75¢	May accept C.P.A. report if assets under $25,000; thereafter free	Only real estate franchise taxes
Ariz.	1929	Yes	1% per mo.	Set by directors	Set by directors	$10	$10	May accept C.P.A. report if assets under $25,000; thereafter "cost"	Not stated in law
Ark.	1931	Yes	10% per yr.	Set by directors	$1,000	$10	$1.50	Not stated in law	Only real estate
Calif.	1927, 1937	Yes	1% per mo.	$300	$3,000	Set in by-laws	$35	"Actual cost," not to exceed $15 per diem	$25 annual fee; no other tax mentioned
Colo.	1931	Yes	1% per mo.	Set by directors	Set by directors	$10	$25	$25 plus 2¢ per $1,000 assets	Only real estate
Conn.	1939	No	1% per mo.	$100	$200 or 10% assets, whichever greater	$5	$50	"Actual cost"	No exemptions and $10 annual fee
Fla.	1929	Yes	1% per mo.	Set by directors	Set by directors	$10	$6.75	May accept C.P.A. report, otherwise $5	Not stated
Ga.	1925	Yes	1% per mo.	$50	Set by directors	$5	35¢	$5–$20, depending on amount of assets	Only property
Idaho	1935, 1939	Yes	1% per mo.	Set by directors	Set by directors	$10	$15	$5 minimum, 25¢ per $100 assets maximum	Only real estate and $5 annual fee
Ill.	1925, 1939	No	1% per mo.	$300	$1,000	$10	$2	$25 plus 2¢ per $1,000 assets	Exempt
Ind.	1923	Yes	1% per mo.	$50	Set by directors	$10	$8.50	$10 for $25,000 assets; then plus 40¢ per $1,000 assets	Same as savings banks
Iowa	1925, 1931	Yes	1% per mo.	$50	Set by directors	$10	$2.50–$2.75	May accept C.P.A. report or "actual cost"	On real estate, money, and credits
Kan.	1929	No	1% per mo.	$50	$1,000	$10	$5	$5–$30 scaled to assets	Not stated in law
Ky.	1922	Yes	"Reasonable"	$50	Set in by-laws	$5	75¢–$3.50	$5 per diem	Only real estate
La.	1924, 1940	No	1% per mo.	$300	$500 or 10% assets, whichever greater	$10	$12	$10	Only real estate

* Source: Questionnaires filled out by the several credit-union supervisors, at writer's request, and inspection of the laws.

TABLE 5—*Continued*

State	Year Enacted and Last Amended	Deposit Accounts	Maximum Interest Rate	Maximum Unsecured Loan	Maximum Secured Loan	Maximum Value of Shares	Organization, Recording, Filing, Fees	Examination Provisions and Fees	Taxation, Annual Fees
Md.	1929, 1937	Yes	1% per mo.	$50	Set by directors	$10	$10	$5 plus 50¢ per $1,000 assets	Only real estate
Mass.	1909, 1926	Yes	"Reasonable"	$100	$4,000	$5	$5	$10 plus 20¢ per $1,000 assets	Exempt
Mich.	1925, 1929	Yes	1% per mo.	Set in by-laws	Set in by-laws	$10	50¢	May accept C.P.A. report if assets under $25,000, or $25	Only real estate
Minn.	1925, 1937	Yes	1% per mo.	Set by directors	Set by directors	$10	75¢	$10–$40 for $25,000 assets plus 10¢ per $1,000 additional assets	As savings banks
Miss.	1924	Yes	1% per mo.	Set in by-laws	Set in by-laws	$10	$10	$10 per diem	Only privilege tax
Mo.	1927, 1933	No	1% per mo.	$50	$1,000	$10	$5	"Actual cost," not over $7 per diem	Shares subject to personal property tax
Mont.	1929	Yes	1% per mo.	Set by directors	Set by directors	$10	$8	For special examination, $15 per diem	Subject to special assessments
Neb.	1919, 1937	Yes	9% per yr.	$100	$1,000	$5	$16.75	$15 per diem	Not stated in law
N.H.	1921, 1929	Yes	6% per yr.	Set in by-laws	Set in by-laws	$10	None	Attested report from credit union considered acceptable	Not stated in law
N.J.	1924, 1938	No	1% per mo.	$100	$1,000	$5	$1	"Actual cost," as assessed	$1 annual fee
N.Y.	1915, 1937	No	1% per mo.	$50–$400, scaled to assets	$500–$2,000, scaled to assets	$25	$2	As assessed	As institutions for savings
N.C.	1915, 1939	Yes	6% disc.	$50	Set by directors	$25	$3	No charges	As institution for saving
N.D.	1935, 1939	Yes	1% per mo.	$50	$200 or 10% assets, whichever greater	$10	$5	Minimum, $5, scaled as for building and loan associations	As savings banks
Ohio	1931	No	1% per mo.	$50	Set by credit committee	$10	$10	"Actual cost" if assets under $25,000; then $1 per $1,000 assets	$10 annual fee in lieu of corporate franchise
Okla.	1933	Yes	10% per yr.	Set by directors	Set by directors	$10	$12	$5	Only real estate
Ore.	1915, 1939	Yes	1% per mo.	$50	$100 or 10% assets, whichever greater	$25	$5	$10 up to $25 when assets are $25,000; then "actual cost"	As mutual savings and loan associations

TABLE 5—*Continued*

State	Year Enacted and Last Amended	Deposit Accounts	Maximum Interest Rate	Maximum Unsecured Loan	Maximum Secured Loan	Maximum Value of Shares	Organization, Recording, Filing, Fees	Examination Provisions and Fees	Taxation, Annual Fees
Pa.	1933, 1937	No	12% per yr.	Set by directors	Set by directors	$10	$30	Cost as assessed	Only real estate
R.I.	1914, 1938	Yes	"Reasonable"	Set by directors	Set by directors	Set in by-laws	$7	40¢ per $100 assets	Only real estate
S.C.	1915, 1922	Yes	7% per yr.	Set by directors	Set by directors	$5	Not stated	Not stated in law	Not stated in law
S.D.	1935	No	1% per mo.	$50	$1,000	$5	$5	"Actual cost," but not over $7 per diem	Not stated
Tenn.	1923, 1937	Yes	"Reasonable"	$50	Set by directors	$5	$5	$15–$50, scaled on assets	As savings banks, and $5 annual fee
Tex.	1913, 1929	Yes	10% per yr.	Set by directors	$1,000	$10	$5	"Actual cost"	$5 annual fee
Utah	1915, 1929	Yes	12% per yr.	$500	$3,000 or 15% assets, whichever less	$5	$10	Form of report stipulated; no fee mentioned in law	Exempt
Va.	1922, 1938	Yes	1½% per mo.	$50	Set by directors	$5	$25 (approx.)	$7.50 plus 60¢ per $1,000 of assets over $2,500	$5–$25, plus .002% of assets over $100,000
Wash.	1933	Yes	1% per mo.	$50	$2,000	$5	$5.25	$3.50 per hour consumed by the examination	Exempt
W.Va.	1925, 1931	Yes	1½% per mo.	$50	Set by directors	$10	$20	$15 if assets under $25,000; when over, $25	Exempt
Wis.	1913, 1935	No	1% per mo.	$100	Set by directors	Set in by-laws	$6–$7	$5–$50, when assets $25,000; then 25¢ per $1,000 added	Exempt
D.C.	1932	No	1% per mo.	$50	Set by directors	$10	$27	$5 plus 3¢ per $1,000 of assets	$15 annual fee
Federal	1934, 1940	No	1% per mo.	$100	$200 or 10% assets, whichever greater	$5	$25	As assessed, now $2.50 minimum, plus 25¢ per $100 of assets	Only real estate and $10 annual fee